99

equatorial energy inc.

1999 ANNUAL REPORT

equatorial energy inc. is a Calgary-based independent corporation engaged in the acquisition, exploration, and development of petroleum and natural gas interests in western Canada and Indonesia.

Corporate Profile

The Corporation's Indonesian investments are held by Equatorial Energy (International) Inc., which owns 100% of Pilona Petro Tanjung Lontar Ltd., 100% of Equatorial Energy (Indonesia) Inc. and 80% of Perkasa Equatorial Sembakung Ltd.

The Corporation has grown rapidly in its first three years of operation, and is now positioned to increase production from its domestic and international properties.

1999 Milestones

Acquired 14,800 mmboe and 400,000 undeveloped acres in Western Canada at a cost of $6.50 per boe proven.

Assembled a talented and experienced team of professionals to exploit and explore the Canadian asset base.

Initiated drilling in the Sembakung oil field in Kalimantan, Indonesia.

Increased production at, and extended the boundaries of, the Arahan-Banjarsari oil field in Sumatra, Indonesia.

Financial Highlights

($000s except per share amounts)	1999	1998
Revenue, net of government take	$ 46,742	$ 2,591
Cash flow from operations	17,269	(2,801)
Net income	2,456	(24,365)
Working capital	3,576	1,902
Long-term debt	73,671	26,575
Shareholders' equity	30,309	6,080
Cash flow per share – basic	1.20	(0.37)
– fully diluted	0.83	(0.37)
Earnings per share – basic	0.13	(3.28)
– fully diluted	0.12	(3.28)

Operational Highlights

	Production	Reserves
Western Canada		
Crude oil and NGLs	2,697 bopd	6,880 mmbbls
Natural gas	22 mmcf/d	80.5 bcf
Indonesia		
Crude oil	3,024 bopd	36,170 mmbbls
Total boes (at 10:1)	7,918	51,000

Drilling	Gross	Net
Western Canada	13	9.6
Indonesia	11	11
Total	24	20.6

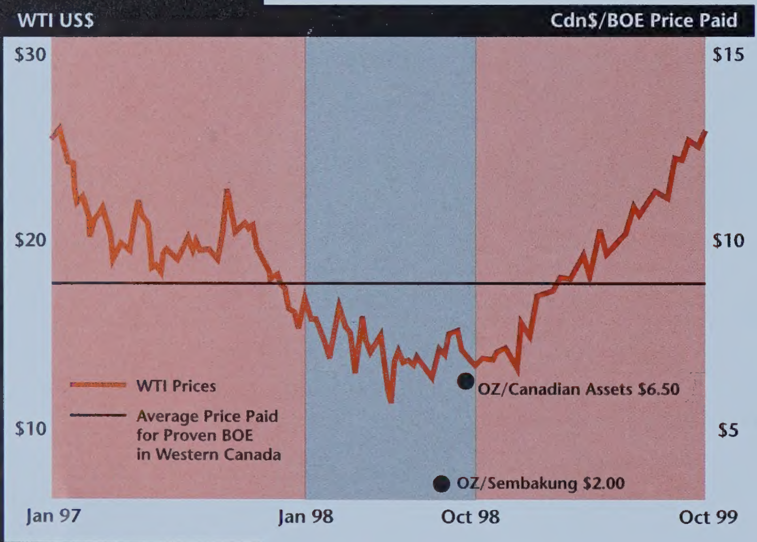
Undeveloped Land (acres)		
Western Canada	455,000	338,000

president's message

Equatorial made significant advances in pursuing our strategy for balanced growth in 1999.

We achieved positive momentum in developing our high quality asset base and greatly increased our financial strength. We have growth potential in our existing reserve base, and we have the financial muscle to develop this potential entirely from internally generated cash flow. Our balanced growth strategy will continue to evolve in 2000 as we take advantage of our valuable, low risk asset base.

Counter Cyclical Acquisitions



We achieved geopolitical balance in our assets with the closing of our domestic oil and gas acquisition on February 26, 1999. This counter-cyclical acquisition provides an excellent foundation in Canada. The purchase of 5,000 bopd and 11 mmstboe (proven) was made for an acquisition price of $70,000,000 that, at $6.50/proven boe, was commensurate with a WTI US$14 price environment. As a result of utilizing debt for the bulk of the transaction, we now enjoy higher per share earnings, cash flows and asset values than if we had utilized more equity. Working with a WTI US$22 assumption, our debt to cash flow estimates for 2000 are in line with industry norms at less than 2:1.

Equatorial's production in 1999 exceeded 7,900 bopd, significantly higher than 1998's average of 862 bopd — and our objective for 2000 is to surpass 10,000 boepd. However, our fixation on financial bottom line growth is paramount and will not be sacrificed to achieve production growth for growth's sake.

Our balanced growth strategy is underpinned by consistent, low risk growth in our Canadian assets, combined with much steeper growth rates from proven reserves in Indonesia. The Western Canadian Sedimentary Basin is becoming advanced in maturity and is hyper-competitive. It is increasingly difficult to attain consistent material returns on equity with traditional Canadian exploration and production growth strategies. On the other hand, Indonesia is under-exploited and is at a maturity level similar to that in Canada 20 years ago. Economic and political conditions are improving in Indonesia, which has emerged from

turmoil in the last three years to become the third largest democracy in the world. The fledgling democracy has received full support from the G7 and the International Monetary Fund. In the long-run, a viable economy will decrease political unrest, and we are pleased to note that Indonesia's gross domestic product has increased monthly over the last year. We are committed to Indonesia where we anticipate consistent and long-term growth.

In Western Canada we have a solid and diverse asset base that we will continue to exploit. Our challenge is to successfully execute an exploration program on our extensive undeveloped land base of 338,000 net acres. We have done well out of the gate with proven finding and development costs for 1999, excluding acquisitions, coming in at a top tier $5.43/boe. We intend to build on this momentum. In addition, in 2000 we will embark on a value-enhancing asset rationalization program.

In Indonesia, 1999 saw the initiation of the development program at the Sembakung field in northeast Kalimantan and an exciting extension to the Arahan-Banjarsari field in South Sumatra. Our seismic and drilling program for 2000 at Banjarsari is designed to further extend the limits of this exciting opportunity. Our last five develo-cat wells averaged over 100 ft. of pay in a high quality reservoir containing 47-53° API crude at less than 1,000 ft. of depth. These wells rarely exceed 30 days to achieve payout. Field production currently is over 1,200 bopd. By May 15, 2000 we will initiate a 25 well development drilling program.

Our largest single asset, the Sembakung field, saw its first infill well drilled in almost 20 years. This is the first exciting step in a multifaceted development program. Initial results are above expectations and field production of 10,000 bopd is a very strong possibility over the next three years.

One of the key components of our success to date has been the dedication of our employees. From northeast Kalimantan to Taber, Alberta, our staff's focus is always on the bottom line. I would like to thank our employees and their families for their unwavering dedication to Equatorial.

I would also like to take this opportunity to thank Larry Jones for his contributions to Equatorial over the last 18 months as Chief Operating Officer.

And finally, I would very much like to thank my wife and children for their continued tolerance and support.

We look forward to your continued support as we move through an exciting phase in Equatorial's growth.

G. Marshall Abbott
President and Chief Executive Officer

operations review

In February 1999, during a period when commodity prices were at historic lows, Equatorial acquired a major asset package in the Western Canadian Sedimentary Basin. The Company now has a portfolio of Canadian assets to balance our international production in Indonesia.

The Canadian assets offer a significant production base and room to grow through a large land component and under-exploited properties. At the same time, the Indonesian assets are poised for substantial production growth through the drilling and extension of existing producing properties — Indonesia represents the exciting upside to Equatorial's growth in the short term.

Corporate Achievements in 1999

In 1999, Equatorial reorganized and enlarged its operating staff to properly control the expanded operations. As the year progressed, the Canadian properties were reviewed for potential production exploitation and a geological team was set upon the task of exploration. During this period, we were able to accomplish the objectives we set forth early in the year:

1. Added reserves of 14,800 mmboe and 400,000 undeveloped acres through the closing of the major western Canadian purchase transaction.
2. Initiated exploitation and review of producing properties, organization of an exploration team and development of prospects on the Canadian properties.
3. Initiated a drilling campaign in the newly acquired Sembakung field in Kalimantan.
4. Increased drilling and production in Indonesia at Arahan-Banjarsari to exploit the existing reserves and extend the known boundaries of the field.

Strategy and Objectives for 2000

The next phase of Equatorial's growth has begun. As a fully operating entity in both Canada and Indonesia the Company intends to:

- Actively explore on the Company's undeveloped acreage in the Western Canadian Sedimentary Basin.
- Implement an ongoing drilling campaign and pressure maintenance program to exploit identified reserves and increase production and cash flow in Sembakung.
- Explore and further extend the boundaries of the Arahan-Banjarsari field in Sumatra through seismic and a low cost drilling program.

Canada

The Canadian production averages 71% working interest and is 78% operated. Nine properties make up more than 75% of production. Reserves are 55% natural gas, while production is currently 53% natural gas.

Northwest Alberta

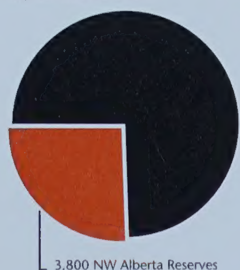
- The area is characterized by medium depth (1,000 – 2,000 m), multi-zone, long life reserves.
- Average working interest of 60% in 153,000 gross acres of undeveloped land.
- Production of 700 boepd.
- In 1999, the area was actively exploited by the Company to bring on production gains through tie-ins and re-completions.
- Recently drilled a successful Kiskatinaw well producing at 240 bopd (120 bopd net).
- Northwest Alberta will be the focus of significant seismic programs to delineate follow-up locations to the recent discovery and to identify drilling locations for later in 2000. Equatorial expects to drill several wells in northwest Alberta during the next year.

Production (boepd)

4,900 Total Production

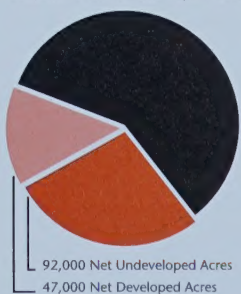
Reserves (thousand boe's)

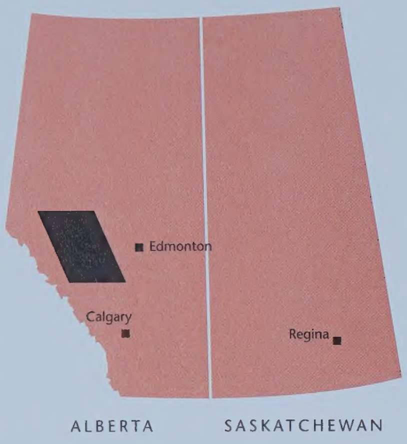
15,000 Gross Reserves



Net Land

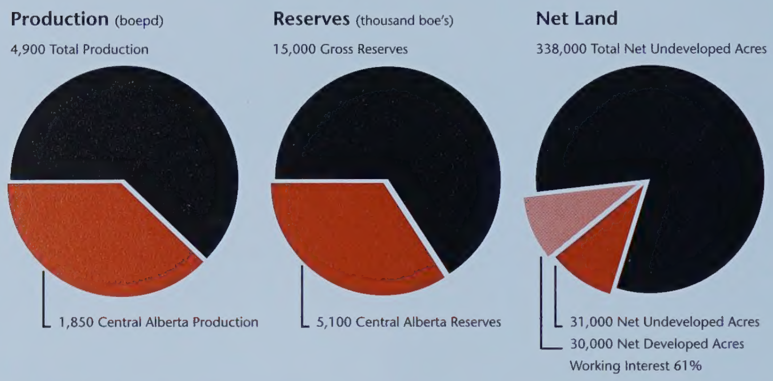
338,000 Total Net Undeveloped Acres

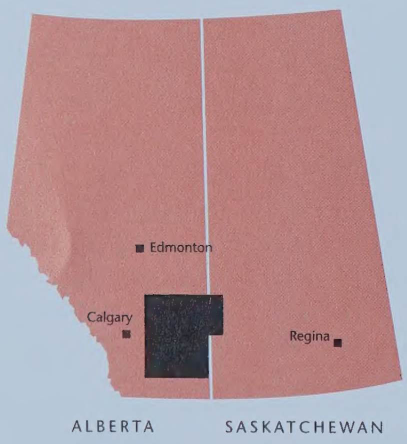




Central Alberta

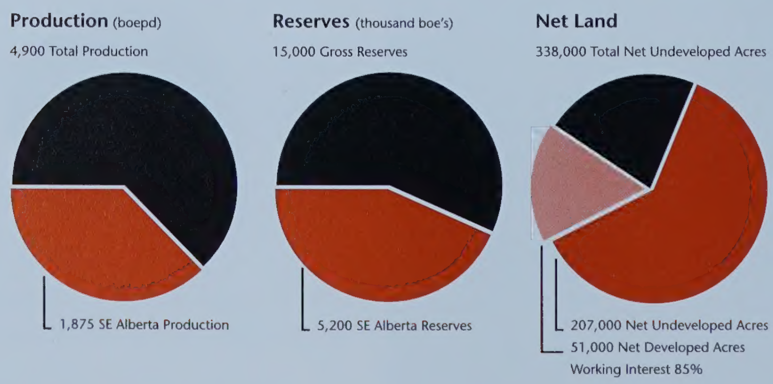
- The area is defined by medium depth, medium cost ($500,000) drilling and multi-zone oil and liquids rich gas targets.
- This core area consists mainly of two large properties and produces over 1,850 boepd.
- Bigoray is a high-interest operated gas prone area that produces 760 boepd through a deep cut processing facility.
- Kaybob South Triassic Unit produces light oil, gas and liquids. It is currently producing over 650 boepd net to the Company. Equatorial owns a 29.94% interest in the unit.
- Equatorial drilled three successful horizontal re-entry in wells in Kaybob in 1999. Two are presently on production at 520 bopd gross with one well temporarily restricted by pipeline capacity, and one well is awaiting completion.

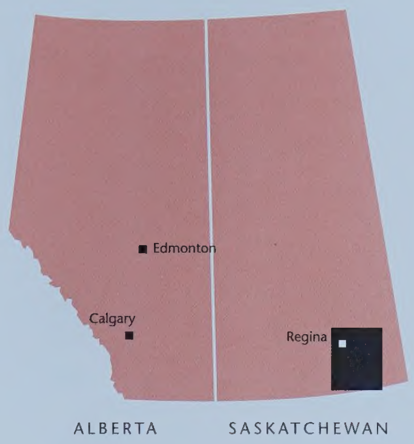




Southeast Alberta

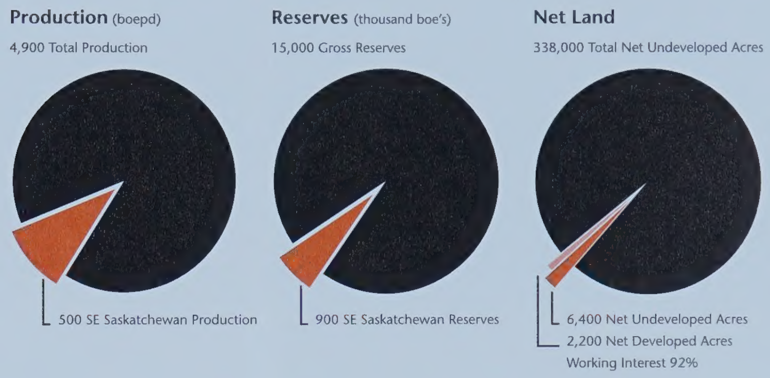
- Shallow horizon (Mannville, Viking, Belly River) primarily natural gas, low cost drilling ($150,000) area producing approximately 1,875 boepd.
- Equatorial drilled seven exploratory wells in the Malmo and Kirkpatrick areas; the Company expects to drill five more in the first half of 2000.
- Existing identified drilling locations for 2000 lie on Company lands in Malmo, Kirkpatrick, Provost, Warwick, Derwent, Grand Forks, Grassy Lake and Hays.
- This year Equatorial expects to achieve operating cost savings in this area through volume increases and sales of non-operated and non-core assets.





Southeast Saskatchewan

- The southeast Saskatchewan properties are shallow to medium depth oil properties, developed by horizontal wells.
- Properties consist of two major fields, Arcola and Wauchope, with high interest operated lands producing approximately 500 bopd net to Equatorial.
- Equatorial will concentrate on increasing production in 2000 through acquisition of area interests and consolidation of facilities for production and water handling.



Land

	Gross Developed Acres	Net Developed Acres	**Average Working Interest**	Gross Undeveloped Acres	Net Undeveloped Acres	**Average Working Interest**
Northwest Alberta	72,506	47,382	65.35	152,996	92,242	60.29
Central Alberta	43,008	29,534	68.67	51,184	31,329	61.21
Southeast Alberta	77,794	50,518	64.94	243,983	207,349	84.98
Southeast Saskatchewan	3,012	2,185	72.53	6,978	6,381	92.46
Canadian Totals	**196,320**	**129,619**	**67.87**	**455,141**	**337,300**	**74.48**

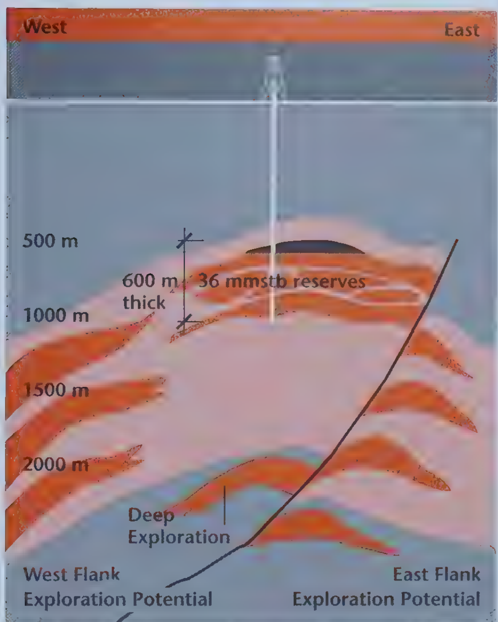
Indonesia

Company operations in Indonesia are conducted through two production sharing arrangements called "Technical Assistance Contracts" (TACs) with Pertamina, the state oil company. Under these TACs, the Company provides financing and technical expertise for development and production activities and earns an interest in the hydrocarbons produced from the contract area. The oil and gas mineral rights are retained 100% by Pertamina for Indonesia.

Sembakung

The Sembakung oil field is the most northerly productive field in Kalimantan. The field comprises a series of stacked deltaic reservoirs of the Miocene Tabul formation, in which 33 separate reservoir zones have been identified.

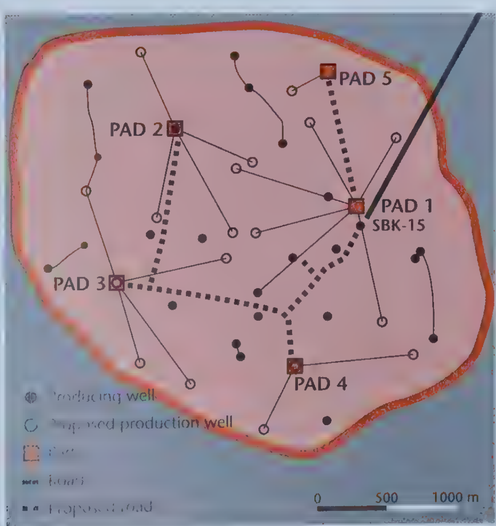
The field is shallow with the top of the currently productive zones at 400 metres and the base at approximately 1,000 metres. The reservoir sand quality is excellent with porosities ranging from 15% to 30% and permeability in the 200 to 1,000 mD range. The sweet crude oil is 37° API gravity with very low gas content, produces wax free and no sulphur.



Equatorial's independent consulting engineers have assigned proven and probable recoverable oil reserves to Sembakung of 36 mmstb as of December 31, 1999.

The Company has an 80% interest in the Sembakung oil field. Under the terms of Equatorial's joint venture agreement with its 20% Indonesian corporate partner, Equatorial is entitled to 100% of net operating profits until all capital expended by the Company to develop the property, together with existing operating loans due the Company plus interest on all outstanding loans and advances, are recovered. At December 31, 1999, the total balance of amounts due to Equatorial prior to our partner's participating in net operating profits is US$9,600,000.

During 1999 the Company initiated the development drilling program at Sembakung with the spudding of SBK 15 in December, 1999. The Pertamina approved work plan and budget for 2000 provides for the drilling of eight wells including SBK 15. In addition, the Company plans to shoot a 3D seismic survey over the field.



The Company is very pleased to date with the performance of the track vehicles and the drilling pad technique. Some challenging drilling conditions have been encountered, which the Company believes will be resolved by adding a "top drive" component to the drill rig, altering drilling fluids and implementing certain casing techniques. As development of Sembakung is approximately a 20 well program, the improvement in drilling techniques is expected to decrease drilling time, lower overall costs and improve field economics.

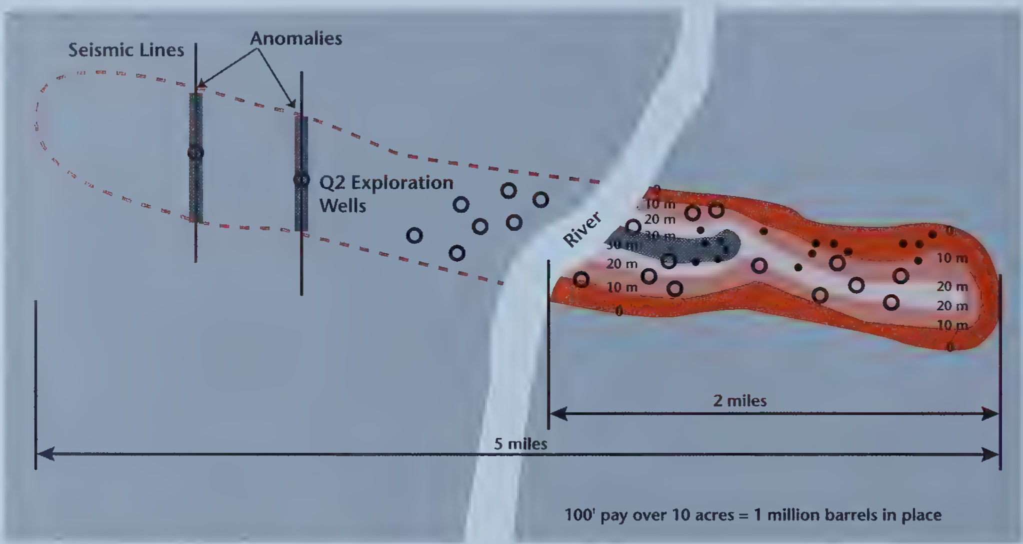
Pilona

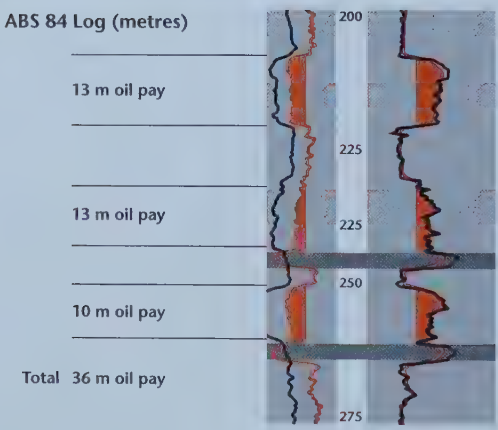
The Pilona TAC is made up of three oil fields located in the Palembang Sub-Basin, which is located onshore in the southeastern part of the South Sumatra Basin. Of the three fields, Tanjung Lontar, Sengkuang and Arahan-Banjarsari, the Arahan-Banjarsari field was the site of the most successful operations in 1999 and contains the most immediate promise for 2000.

During 1999, the Pilona TAC produced an average of 289 bopd. Drilling commenced at Arahan-Banjarsari in January 1999, and has resulted in significant production gains. Ten wells have added 900 bopd of production and the TAC is currently producing 1,200 bopd. Production history from these new wells is limited, consequently reserves assigned to these wells as of December 31, 1999 have been conservative. Continued performance and field extension could add significant reserves in 2000.

Plans for 2000 include drilling up to 25 wells, of which at least two will be at the west end of the concession where seismic highs show the field structure extending three miles to the west. In addition, the Company plans to shoot a 3D seismic survey over the area immediately to the west of the recent 1999 drilling success to help identify locations. Drilling is scheduled to recommence in May 2000.

This well was drilled in the 1930's and suspended at the onset of World War II. The well blew out in January 2000 and was flowing up to 200 bopd.





The Company also constructed a 45 kilometre pipeline from these fields to the sales delivery point. This pipeline will be operational in April 2000, has a capacity of 1,500 bopd and is expected to eliminate shut-ins due to seasonal inclement weather and reduce trucking costs.

Reserves

Equatorial's reserves are reported as of December 31, 1999 by Gilbert Laustsen Jung. The Company's proven reserves are 47% oil and natural gas liquids and 53% gas in Canada and 100% oil in Indonesia. On a combined basis, the Company's proven reserves are 76% oil and natural gas liquids and 24% gas.

Summary of Reserve Values and Volumes

	Reserves		B.T. Net Present Values (Cdn$000s)		
	Oil mmstb	Gas mmcf	0%	10%	15%
Canada					
Total proven	4,890	55,000	$ 148,000	$ 108,000	$ 97,000
Total probable	1,990	25,500	55,000	34,000	28,000
Total proven plus probable	6,880	80,500	$ 203,000	$ 142,000	$ 125,000
Indonesia					
Total proven	13,238	–	$ 48,900	$ 37,200	$ 33,200
Total probable	22,932	–	107,300	55,600	41,600
Total proven plus probable	36,170	–	$ 156,200	$ 92,800	$ 74,800
Total Company					
Total proven	18,128	55,000	$ 196,900	$ 145,200	$ 130,200
Total probable	24,922	25,500	162,300	89,600	69,600
Total proven plus probable	43,050	80,500	$ 359,200	$ 234,800	$ 199,800

Finding and Development Costs

The Company was successful in making a large, low cost acquisition in each of 1998 and 1999. Consequently, the Company's finding and development costs for each year are among the lowest in the industry. Low finding and development costs are essential to ensuring future profitability.

1999 Finding and Development Costs	With Acquisitions	Without Acquisitions
Net capital expenditures ($000s)	86,784	16,616
Proven reserve additions mboe	12,537	2,107
Proven boe finding costs per boe	$ 6.92	$ 7.89
Proven plus probable reserves additions	17,077	2,269
Proven plus probable boe finding costs	$ 5.08	$ 7.32

Net Asset Value (at 10% PV)	Canada	Indonesia	Total
Reserves (P + 1/2P) ($000s)	125,113	65,000	190,113
Land ($65/acre) ($000s)	21,970	–	21,970
Net debt ($000s)	(70,094)	–	(70,094)
Net asset value	76,989	65,000	141,989
NAV per share – basic			$ 7.59
– fully diluted			$ 5.30

Marketing

Crude Oil

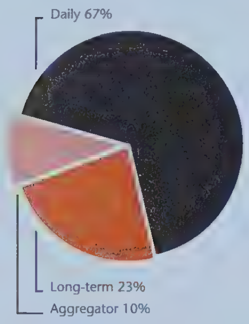
Equatorial utilizes the services of one of Canada's largest crude oil marketing companies to market its share of production in Western Canada.

Crude oil volumes are contracted and sold on a 30-day evergreen basis at major Canadian transportation hubs including Edmonton and Hardisty, Alberta and Cromer, Manitoba. Larger shippers attract better prices; therefore purchase contracts are structured so that Equatorial will always receive a premium to industry benchmark postings on each of its five major crude types. The exposure to heavy oil is nil, resulting in increased netbacks for the Company's average 35° API gravity crude.

In Indonesia, Equatorial's crude oil production averages 38° API and is sold directly to Pertamina at WTI less US$1.70 per barrel.

Natural Gas

Natural Gas Sales



The North American supply/demand balance has never looked more favorable for gas. Despite several warmer than usual winters the growing demand for gas has exceeded the industry's ability to bring on new supply. Although the industry has now responded with record gas drilling activity, Equatorial believes that gas prices will stay high for at least the next two years.

The Company's strategy is to sell gas on the Alberta spot market. Recently, gas sold to markets outside Alberta has returned lower value than gas sold in Alberta due to tolls for expansion of pipelines. Accordingly, Equatorial's only exposure to the export markets is through aggregators, and this represents only 10% of production.

Within Alberta, NOVA's new tolling means companies whose production is further north will pay more. To mitigate this, Equatorial is shedding any transport that is not fully utilized and is in discussions with other parties to swap capacity where it is mutually beneficial.

Drilling

Canada	Oil	Gas	Dry	Gross	Net	Average Working Interest
Northwest Alberta	–	–	–	0	0	–
Central Alberta	1.3	0.04	1.0	5	2.3	46%
Southeast Alberta	–	4.00	3.3	8	7.3	92%
Southeast Saskatchewan	–	–	–	0	0	–
	1.3	4.04	4.3	13	9.6	74%
Indonesia						
Tanjung Lontar	10	–	–	10	10.0	100%
Sembakung	1	–	–	1	1.0	100%
	11	–	–	11	11.0	100%

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of the Company's financial affairs should be read in conjunction with the Consolidated Financial Statements and related notes contained elsewhere in this Annual Report.

Results of 1999 Operations

In 1999, Equatorial diversified its operating base by adding Canadian oil and gas activities to the existing Indonesian oil and gas operations. Prior to 1998, the Company had no revenues and as such the periods prior to 1998 are not comparable to 1998 or 1999.

In each of 1999 and 1998 acquisitions were the dominant component of the capital investment program. In 1999, $70,168,000 of the total capital investment program of $89,999,000 related to the acquisition of assets in Western Canada. In 1998, $29,229,000 of the total capital investment program of $38,102,000 related to the acquisition of the Sembakung field in Indonesia. These two acquisitions dramatically changed the Company and 1999 operating results are an early indication of strong future operating results.

Production volumes increased 918% from 862 boepd in 1998 to 7,918 boepd in 1999. On a stand-alone basis, Indonesian production volumes were 3,024 in 1999 compared to 862 in 1998.

Volume increases are due to a number of factors. The Sembakung acquisition took place in September 1998, therefore that year does not reflect a full year's operating results of that asset. The Western Canadian property acquisition is accounted for as of January 1, 1999, so 1998 reflects no Canadian operations, whereas 1999 is a full year. Finally, drilling at Tanjung Lontar and Sembakung commenced in late 1999 so those production gains are partially felt in 1999, but are expected to have a much larger impact on 2000 production volumes.

Revenues

Petroleum and natural gas revenues increased 1,214% from $5,501,000 in 1998 to $72,257,000 in 1999. This increase reflects both of the acquisitions made during 1998 and 1999, as well as improved commodity prices. 1999 revenues are net of hedging losses of $2,458,000, whereas no hedges were in place in 1998.

Oil prices experienced severe volatility during 1999, ranging from recent historic lows of WTI US$12.50 during the month of February to highs of $30.00 during the month of December. Realized prices for oil and natural gas liquids averaged CDN$17.47 during 1998, whereas the corresponding number for 1999 was $25.78. It appears oil prices will be strong through 2000.

Realized natural gas prices for 1999 averaged $2.81/mcf. There was no natural gas production prior to 1999 for comparison purposes. Natural gas prices appear likely to remain strong through 2000.

Royalties/Government Take

Royalties are a combination of freehold, crown and overriding royalties in Canada and government take in Indonesia. The apparently high royalty rates are a reflection of the nature of the Company's contractual relationship with the Indonesian authorities, as displayed in the segmented information in Note 10 of the consolidated financial statements.

Royalties on production from Indonesian properties represent the entitlement of the Indonesian government and Pertamina to a portion of the Company's production, and are recorded using rates in effect under the terms of contracts at the time of production.

Included in the calculation of government take in the Sembakung TAC is a concept of "Non-Shareable Oil" (NSO). NSO is a calculated amount of total production that is not subject to sharing, although the Company is responsible for operations relating to this production. The Indonesian government pays for that portion of operating costs relating to NSO, but is not responsible for any capital costs. NSO volumes in 1999 were 1,335 bopd and declines, under the terms of the TAC, at 13.3% annually.

In addition to NSO at Sembakung, government take includes a share of the production from each TAC based upon the terms of the contract. Under the terms of Equatorial's TACs, the Company is entitled to use gross proceeds of production of shareable oil to recover substantially all of the non-capital costs incurred in the development of the contract area as well as current year depreciation for capital costs and any costs unrecovered in prior years. The maximum cost recovery in any year is 80% of shareable oil revenue. Upon recovery of all costs, the Company's share of revenue reverts to approximately 29%.

This cost recovery concept is similar to a typical 100% for 50% farm-in in Western Canada, with the two major differences being that in Indonesia the costs are on an area basis rather than well by well, and in Indonesia the government pays their share of operating costs both before and after payout.

Royalty/Government Take	1999			1998		
	Canada	Indonesia	Total	Canada	Indonesia	Total
Revenue ($000s)	$ 42,962	$ 29,295	$ 72,257	–	$ 5,501	$ 5,501
Royalty/government take ($000s)	8,796	16,719	25,515	–	2,910	2,910
Government take (%)	20%	57%	35%	N/A	53%	53%

Royalty rates are expected to decline in 2000 as capital expenditures at Sembakung results in cost recovery of higher production volumes, and the NSO component declines in total and as a proportion of total production.

Operating Costs

Operating costs increased from $2,847,000 in 1998 to $20,169,000 in 1999. However, on a boe basis, operating costs decreased from $9.04 in 1998 to $6.98 in 1999.

In Canada, operating costs in 1999 were $6.22 per boe, compared to an estimated $7.50 per boe during 1998, when the properties were under the control of the previous owner. Rationalization through property sales and consolidation of interests in 2000 are expected to further lower operating costs per boe in Canada.

In Indonesia, under the terms of Equatorial's TACs, the Company has the right to recover all costs defined as Operating Costs in each TAC against available revenues generated by the TAC. Operating costs consist of current year non-capital costs, current year depreciation on capital costs and current year allowed recovery of prior year's unrecovered operating costs. This recovery of operating costs relates to 100% of the Shareable Oil and is reflected in the Company's share of revenues. Operating costs relating to Non Shareable Oil (NSO) are paid by the government and are not included in the Company's income statement.

Much of the Indonesian field operating costs are fixed in nature. Consequently, as production increases during 2000, operating costs per boe are expected to decline.

Operating Costs	1999			1998		
	Canada	Indonesia	Total	Canada	Indonesia	Total
Operating costs ($000s)	$ 11,111	$ 9,058	$ 20,169	N/A	$ 2,847	$ 2,847
Total boe	1,786,070	1,103,880	2,889,950	N/A	314,868	314,868
Cost/boe	$ 6.22	$ 8.21	$ 6.98	N/A	$ 9.04	$ 9.04

General and Administrative Expenses

General and administrative expenses increased from $1,423,000 in 1998 to $3,253,000 in 1999, reflecting the increased cost of managing the Western Canadian assets acquired in 1999 and the Sembakung asset acquired in September 1998. On a boe basis, general and administrative costs were $1.13 in 1999 compared to $4.52 in 1998.

General and Administrative Expenses ($000s)	1999			1998		
	Canada	Indonesia	Total	Canada	Indonesia	Total
Gross expenses	$ 4,470	$ 1,202	$ 5,672	$ 1,423	$ 338	$ 1,761
Allocated to						
– Capital projects	1,025	1,018	2,043	–	338	338
– Operating expense	146	–	146	–	–	–
– Third party recoveries	230	–	230	–	–	–
Net expenses	3,069	184	3,253	1,423	–	1,423
Average cost per boe						
– Gross	$ 2.50	$ 1.09	$ 1.96	$ N/A	$ 1.07	$ 5.59
– Net	$ 1.72	$ 0.17	$ 1.13	$ N/A	$ 1.07	$ 4.52

Long-term Debt, Interest and Financial Expenses

Debt outstanding increased from nil in 1997 to $24,575,000 due to the Sembakung acquisition in September of 1998. Debt outstanding increased by $54,966,000 in 1999 due to the acquisition of the Western Canadian assets. In addition, a $2 million convertible debenture was issued in 1998. During 1999, $3 million of the long-term bank debt was repaid and $1.65 million of the convertible debentures were converted into common shares. Subsequent to December 31, 1999, a further $1.15 million of bank debt was repaid and the remaining $350,000 of the convertible debentures were converted.

Continuity of Long-term Debt	
Balance, December 31, 1997	NIL
Convertible debentures issue	$ 2,000,000
Vendor debt financing on Sembakung acquisition	24,575,000
Balance, December 31, 1998	$ 26,575,000
Bank financing on Canadian asset acquisition	45,000,000
Vendor financing on Canadian asset acquisition	9,666,000
Issue of US$ notes	1,411,000
Foreign exchange gains on US$ notes	(1,264,000)
Repayment of Sembakung vendor financing	(3,067,000)
Repayment of bank debt	(3,000,000)
Conversion of convertible debentures	(1,650,000)
Balance, December 31, 1999	$ 73,671,000

Capital Taxes

Federal capital taxes are a function of year-end debt and equity levels. Growth in the Company has resulted in higher federal capital taxes. The Saskatchewan capital tax is in substance a royalty, and is reported as part of royalty expense. Indonesia collects no capital taxes.

Capital Taxes	1999	1998
Federal capital tax	$ 180,000	–
Average cost per boe (at 10:1)	$ 0.10	–

Depletion, Depreciation and Site Restoration

In 1999, depletion, depreciation and site restoration increased to $14,365,000 from $2,468,000 in 1998. This increase is commensurate with production increases. On a boe basis, depletion, depreciation and site restoration was $4.97 in 1999 and $7.70 in 1998. The low rates are due to the low cost of the acquisitions in 1999 and 1998.

Depletion, Depreciation and Site Restoration ($000s)	1999			1998		
	Canada	Indonesia	Total	Canada	Indonesia	Total
Depletion and depreciation	$ 8,506	$ 3,851	$ 12,357	$ 45	$ 2,423	$ 2,468
Site restoration	2,008	–	2,008	0	–	–
Total	$ 10,514	$ 3,851	$ 14,365	$ 45	$ 2,423	$ 2,468
Average per boe	$ 5.89	$ 3.49	$ 4.97	$ 0	$ 7.70	$ 7.70

Net Earnings

In 1999, Equatorial recorded net earnings of $2,456,000, the first earnings in the Company's history. This significant step forward is a result of low depletion rates and high commodity prices. The low depletion rates, as noted above, are the direct result of bottom-of-the-cycle low cost acquisitions in both 1998 and 1999. With the expectation of continued strong commodity prices, earnings and return on equity should increase for 2000 and beyond.

Business Risks

The oil and gas business is fraught with risks, including but not limited to operational, financial, and political and regulatory risks.

Operational Risks

Operational risks include geological interpretation, down hole operations, drilling of wells, and processing and delivery of commodities. The key element in controlling operational risks is to recruit and retain top quality and experienced professional staff. This is accomplished by establishing compensation arrangements competitive in our industry and community, and by providing employees with a challenging and professional work environment. In addition, other methods of mitigating operational risks include:

- maintaining a diversified high quality asset base;
- maintaining appropriate emergency response plans; and
- maintaining prudent levels of insurance.

Equatorial acknowledges these risks and has an ongoing comprehensive review to monitor these risks.

Financial Risks

Financial risks include commodity prices, exchange rates, interest rates and availability of capital resources. The Company addresses these risks by:

- utilizing derivatives where appropriate to provide certainty of cash flow;
- maintaining a prudent level of equity on the balance sheet; and
- maintaining both US dollar and Canadian dollar debt structures.

The derivative hedge transactions in place are detailed in Note 13 to the consolidated financial statements.

Political and Regulatory Risks

In Canada, regulatory risks included the governments' energy policies, taxation laws and operational laws. The oil and natural gas business in Canada has historically been subject to a high degree of government regulation and intervention. To mitigate these risks, the Company maintains programs on regulatory compliance, safety and environmental matters. In addition, the Company has an active program of well site and facility reclamation and restoration.

In Indonesia, the financial markets and political environment have gone through significant change during the past year. Free elections in Indonesia in 1999 resulted in a new democratically elected government whose major thrust appears to be political and economic reform. The International Monetary Fund has responded with a commitment to resume funding assistance. Economic activity is rapidly returning to higher levels, and the political environment is stable. The Company applauds these efforts and the successes and accomplishments of the new government. Under current economic and political conditions, we believe the Company can make an economic contribution to both the people of Indonesia and our shareholders.

Management's Report

To the Shareholders of Equatorial Energy Inc.:

The consolidated financial statements of Equatorial Energy Inc. were prepared by and are the responsibility of management. The statements have been prepared in conformity with the Canadian generally-accepted accounting principles appropriate in the circumstances and include some amounts that are based on management's best estimates and judgements.

The Corporation maintains systems of internal accounting controls designed to provide reasonable assurance that all transactions are properly recorded in the Corporation's books and records, that policies and procedures are adhered to, and that assets are protected from unauthorized use. The systems of internal accounting controls are complemented by the selection, training, and development of professional financial managers.

The consolidated financial statements have been audited by the independent accounting firm, Deloitte & Touche LLP, whose appointment will be ratified yearly by the shareholders at the annual shareholders' meeting. The independent accountants conduct a review of internal accounting controls to the extent required by generally-accepted auditing standards and perform such tests and related procedures as they deem necessary to arrive at an opinion on the fairness of the financial statements.

The Audit Committee of the Board of Directors periodically meets with the independent accountants and management to satisfy itself that it is properly discharging its responsibilities. The independent accountants have unrestricted access to the Audit Committee, without management present, to discuss the results of their examination and the quality of financial reporting and internal accounting control.

G. Marshall Abbott
President and Chief Executive Officer
March 23, 2000

J. Rooney

John R. Rooney
Senior Vice-President and Chief Financial Officer

Auditors' Report

To the Shareholders of Equatorial Energy Inc.:

We have audited the consolidated balance sheets of Equatorial Energy Inc. as at December 31, 1999 and 1998 and the consolidated statements of income and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1999 and 1998 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in Canada.

Deloitte & Touche LLP

Deloitte & Touche LLP,
Chartered Accountants
Calgary, Alberta
March 23, 2000

Consolidated Balance Sheets

December 31 (000s)	1999	1998
Assets		
Current		
Cash	$ 8,156	$ 5,644
Accounts receivable	13,267	5,388
	21,423	11,032
Petroleum and Natural Gas Interests (Note 5)	109,829	37,257
	$ 131,252	$ 48,289
Liabilities		
Current		
Accounts payable and accrued liabilities	$ 17,847	$ 9,130
Current portion of long-term debt (Note 6)	5,017	1,533
	22,864	10,663
Long-term Debt (Note 6)	68,654	25,042
Deferred Income Taxes	7,604	6,504
Site Restoration and Abandonment	1,821	–
Shareholders' Equity		
Share capital (Note 7)		
Common shares	16,513	32,047
Series 1 convertible preferred shares	12,000	–
Retained earnings (deficit)	1,796	(25,967)
	30,309	6,080
	$ 131,252	$ 48,289

See accompanying notes

On behalf of the Board

G. Marshall Abbott, Director

David N. Matheson, Director

Consolidated Statements of Income and Retained Earnings

Years Ended December 31 (000s)	1999	1998
Revenue		
Gross oil and natural gas revenue	$ 72,257	$ 5,501
Royalties and government take	(25,515)	(2,910)
	46,742	2,591
Expenses		
Operating	20,169	2,847
Depletion and depreciation	14,365	2,468
Interest – long-term debt	6,494	846
Administrative	3,253	1,423
Foreign exchange (gain) loss	(595)	276
Write-down of petroleum and natural gas interests	–	19,096
	43,686	26,956
Income (Loss) Before Income Taxes	3,056	(24,365)
Income Taxes (Note 11)	600	–
Net Income (Loss) for the Year	2,456	(24,365)
Deficit, Beginning of Year	(25,967)	(1,602)
Dividends paid on preferred shares (Note 7)	(660)	–
Reduction of common share stated capital (Note 7)	25,967	–
Retained Earnings (Deficit), End of Year	$ 1,796	$ (25,967)
Net income (loss) per common share – basic (Note 9)	$ 0.13	$ (3.28)
Net income (loss) per common share – fully diluted (Note 9)	$ 0.12	$ (3.28)

Statements of Cash Flows

Years Ended December 31 (000s)	1999	1998
Cash Flows from the Following:		
Operating Activities		
Net income (loss) for the year	$ 2,456	$ (24,365)
Items not affecting cash:		
Depletion and depreciation	14,365	2,468
Deferred income taxes	1,100	–
Amortization of deferred foreign exchange gain	(652)	–
Write-down of petroleum and natural gas interests	–	19,096
Cash flow from (used in) operations	17,269	(2,801)
Changes in non-cash working capital	838	4,420
	$ 18,107	$ 1,619
Financing Activities		
Issue of bank debt	$ 45,000	$ –
Issue of common shares (net of issue expenses)	14,145	3,280
Issue of US$ notes	1,411	569
Repayment of long-term debt	(6,067)	–
Issue (conversion) of debenture	(1,650)	2,000
Deferred financing charges	(643)	–
Dividends paid on preferred shares	(660)	–
	51,536	5,849
Investing Activities		
Purchase of petroleum and natural gas interests	(48,502)	(2,433)
Petroleum and natural gas expenditures	(19,831)	(8,873)
Proceeds on sale of petroleum and natural gas interests	2,000	–
Site restoration and abandonment	(187)	–
	(66,520)	(11,306)
Foreign exchange gain on long-term debt – deferred	(611)	–
Increase (Decrease)	2,512	(3,838)
Cash, Beginning of Year	5,644	9,482
Cash, End of Year	$ 8,156	$ 5,644
Cash flow from (used in) operations per common share – basic (Note 9)	$ 1.20	$ (0.37)
Cash flow from (used in) operations per common share – fully diluted (Note 9)	$ 0.83	$ (0.37)

Notes to Consolidated Financial Statements

Years Ended December 31 (tabular amounts are in thousands of dollars except for share and per share amounts)

1. Nature of Business

Equatorial Energy Inc., and its subsidiaries (the "Corporation") is in the business of exploration for and development of petroleum and natural gas interests.

2. Significant Accounting Policies

(a) Basis of presentation

The consolidated financial statements are presented in accordance with generally accepted accounting principles applicable in Canada and are expressed in Canadian dollars.

(b) Basis of consolidation

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries Equatorial Energy (International) Inc. ("EQII"), Pilona Petro Tanjung Lontar Ltd. ("Pilona"), Equatorial Energy (Indonesia) Inc. ("EEII") (formerly Energy Process Services Ltd.) and Auckland Investments Pty. Ltd. The consolidated financial statements also include the accounts of its 80% owned subsidiary Perkasa Equatorial Sembakung Ltd. ("Perkasa"). All significant intercompany transactions and accounts have been eliminated.

(c) Cash

Cash includes short-term investments with a maturity of 90 days or less at the time of issue.

(d) Petroleum and natural gas interests

The Corporation follows the full cost method of accounting for petroleum and natural gas interests whereby all costs of exploring and developing petroleum and natural gas reserves, net of government grants, are capitalized by individual country cost centre. Such costs include land acquisition costs, geological and geophysical expenses, costs of drilling both productive and non-productive wells, tangible equipment and overhead charges directly related to acquisition, exploration and development activities.

The total carrying value of the Corporation's petroleum and natural gas interests, less accumulated depletion and depreciation, is limited to the estimated future net revenue from production of proven reserves, based on unescalated prices and costs plus the lower of cost and net realizable value of unproved properties, less estimated future development costs, site restoration and abandonment costs, general and administrative expenses, financing costs and income taxes. The carrying value of unproved properties is reviewed periodically to ascertain whether impairment has occurred. If impairment occurs, the costs will be written down to their net realizable value.

For each cost centre, the costs associated with proved reserves are depleted or depreciated on the unit-of-production method based on an independent engineering estimate of proved reserves, after royalties, with natural gas converted to its energy equivalent at a ratio of six thousand cubic feet of natural gas to one barrel of oil.

In Indonesia, the Corporation has no ownership interest in the producing assets nor in the oil and gas reserves, but rather has the right to operate the assets and receive production and/or revenues from the sale of oil and gas in accordance with the petroleum sharing agreements. Proved reserves have therefore been determined on a net entitlement basis, which takes into account projections of the government's share of production calculated with certain price and expenditure assumptions.

The Corporation provides for future estimated site restoration costs using the unit-of-production method based on costs and regulations in effect at the end of the year.

Office equipment is amortized on a straight-line basis over five years.

(e) Government take

Operations conducted jointly with the Indonesian national oil company ("Pertamina") are reflected in these financial statements based on the Corporation's proportionate interest in such activities. All Pertamina interests, other than income taxes, are considered to be government take. Government take on production from Indonesian properties represents the entitlement of Pertamina to a portion of the Corporation's share of crude oil, liquids and natural gas production and are recorded using rates in effect under the terms of contracts at the time of production.

Under the terms of each contract, the Corporation is entitled to use gross proceeds of production to recover substantially all of the non-capital costs incurred during each year as well as current year depreciation for capital costs and any costs unrecovered from prior years. Such gross proceeds of production are included in revenue before government take.

The maximum cost recovery in any year is 80% of gross revenue for the first two years of production, and depending on the production sharing contract, 65% to 80% thereafter. Pertamina and the Corporation are entitled to share the remaining oil profits based upon the terms in each contract. The Corporation's pre-tax profit share on oil production is generally the rate that will provide an after-tax profit share of 15%.

(f) Foreign currency translation

Transactions of the Corporation that are denominated in foreign currencies are recorded in Canadian dollars at exchange rates in effect at the related transaction dates. Monetary assets and liabilities denominated in foreign currencies are adjusted to reflect exchange rates at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect when the assets were acquired or the liabilities assumed. Exchange gains and losses arising on the translation of monetary assets and liabilities, are included in the determination of income for the year with the exception of unrealized gains or losses on translation of long-term monetary liabilities, which are deferred and amortized over the remaining term of such liabilities.

(g) Stock based compensation plans

The Corporation has stock based compensation plans which are described in Note 8. No compensation expense is recognized when stock options are issued. Any consideration paid on exercise of stock option is credited to share capital. The Corporation may grant share appreciation rights as described in Note 8. The cost of such rights is accrued over the period it relates to and accounted for as an expense.

(h) Flow-through shares

Under the terms of the flow-through shares, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregone tax benefits, the carrying value of petroleum and natural gas interests and share capital are reduced by the amount of the tax benefits renounced at the time that the related expenditures are made.

(i) Joint venture activities

The Corporation's exploration and development activities are conducted jointly with others, and accordingly, the accounts reflect only the Corporation's proportionate interest in such activities.

(j) Income taxes

The Corporation follows the deferral method of accounting for income taxes.

3. Purchase of Western Canadian Oil and Gas Properties

On February 26, 1999, the Corporation closed the purchase of certain Western Canadian oil and gas properties. Revenues and expenses for the properties have been recorded effective from January 1, 1999. Consideration given was as follows:

Cash, net of accrued cash flow from October 1, 1998 to December 31, 1998	$ 47,045
Interest due on purchase price from October 1, 1998 to December 31, 1998	1,457
Total cash consideration	48,502
Convertible preferred shares (Note 7)	12,000
Promissory note (Note 6)	9,666
	$ 70,168

The entire amount of $70,168,000 was allocated to the Corporation's petroleum and natural gas interests.

4. Acquisition of Equatorial Energy (Indonesia) Inc. ("EEII")

Effective September 14, 1998, the Corporation acquired 100% of the issued and outstanding common shares of EEII. EEII owns 80% of Perkasa Equatorial Sembakung Ltd. ("Perkasa"), which holds a production sharing arrangement called a Technical Assistance Contract ("TAC") for a producing oilfield in East Kalimantan, Indonesia.

Net assets acquired, using the purchase method of accounting:

Petroleum and natural gas interests	$ 34,872
Working capital	862
Deferred income taxes	(6,505)
	$ 29,229

Consideration given:	
Cash	$ 1,531
Closing expenses	902
Total cash consideration	2,433
Long-term debt (Note 6)	24,006
2,250,000 common shares of the Corporation (Note 7)	2,790
	$ 29,229

Contingent consideration of US$3,000,000 is payable, during the life of the TAC, when the petroleum property achieves the following average daily production targets for a 30 day period:

a) 7,500 barrels of oil per day – US$1,000,000 plus accrued interest
b) 10,000 barrels of oil per day – US$1,000,000 plus accrued interest
c) 12,000 barrels of oil per day – US$1,000,000 plus accrued interest

This consideration is secured by a promissory note due 30 days after each target is met. The additional cost represented by these notes will be recorded as petroleum and natural gas interests by the Corporation at that time. Interest at Chase Manhattan bank prime plus 3% accrues from September 14, 1998 to the due date.

Until September 14, 2001, 2,250,000 common shares issued on the transaction are subject to a voting trust agreement in favor of either of two senior officers and directors of the Corporation. The trust expires if both senior officers leave the Corporation, or if the Corporation's noteholders elect to convert their notes under certain events of default (Note 6).

The holder of 1,379,033 of the 2,250,000 common shares issued on the transaction will have the right to appoint a nominee to the Corporation's board for as long as that shareholder has at least 10% of the Corporation's voting shares.

Under the terms of the Perkasa shareholders' agreement, the Corporation will own a 100% revenue interest in the TAC. Once the Corporation pays the Indonesian government take, recovers its capital expenditures and collects any interest and principal on capital funds loaned to the 20% Perkasa minority interest, its working interest reverts to 80%.

5. Petroleum and Natural Gas Interests

	Cost	Accumulated Depletion and Depreciation	Net Book Value
1999			
Petroleum and natural gas interests	$ 141,041	$ (31,697)	$ 109,344
Other assets	619	(134)	485
	$ 141,660	$ (31,831)	$ 109,829
1998			
Petroleum and natural gas interests	$ 58,607	$ (21,519)	$ 37,088
Other assets	220	(51)	169
	$ 58,827	$ (21,570)	$ 37,257

The ceiling tests performed at December 31, 1999 indicate that there are no write-downs required for 1999.

During 1998, management reviewed its properties and made a provision of $19,096,394 to write down the carrying value of the Pilona TAC in Indonesia under a ceiling test write down and the interest in Australia and Trinidad to estimated net realizable value. The Corporation also subjected the costs related to the Perkasa TAC to a ceiling test calculation which indicated that, based on December 31, 1998 oil prices, an additional ceiling test write down of $19,000,000 would be necessary. Under the provisions of the CICA guideline for full cost accounting in the oil and gas industry, the Corporation chose not to record this write down because the costs related principally to the acquisition of EPS, effective September 14, 1998 (within 24 months of this year end), and management believed that the value of the EPS assets were not permanently impaired.

As at December 31, 1999, unproved properties with capitalized costs of $16,976,464 (1998 – $16,976,464) for Indonesian properties and $18,551,500 (1998 – nil) for Canadian properties were not subject to depletion.

During the year ended December 31, 1999 the Corporation capitalized overhead charges related to petroleum and natural gas exploration and development activities of $2,419,000 (1998 – $338,000).

6. Long-term Debt

	1999	1998
Five year revolving and term bank credit facility with interest accruing monthly at the Corporation's choice of any of the following rates: Canadian prime plus 1%, U.S. Base rate plus 1%, LIBOR rate plus 2% or Bankers' Acceptance rate plus 2% quarterly. Quarterly principal repayments of $1,150,000 each, are due in each of the first seventeen quarters and $1,450,000 on maturity. There are no repayments required on the remaining revolving balance of the loan. The loan is secured by a fixed and floating charge debenture, over the Western Canadian oil and gas properties (see Note 3) and by a general security agreement.	**$ 42,000**	$ –
US$13,686,000 promissory notes, due on March 28, 2001. Simple interest accrues at 10% and is paid quarterly. Interest payments for the quarters ended December 14, 1998 and March 14, 1999 were capitalized and added to the principal.	**20,746**	21,509
Promissory note due on the later of February 25, 2005 and one day following the repayment by the Corporation of all amounts owing under its existing bank agreements. Interest accrues and is paid quarterly at 7.2% per annum. The Corporation may pre-pay any or all of the outstanding principal and interest, but must, in certain circumstances, pay a pre-payment premium of 13.33% which would decline by 2.22% per calendar year until it becomes 1.11% in 2005 and expires thereafter. At the option of the vendor, the note and any accrued interest is convertible, in the event of certain events of default, into common shares at a price of $2.2712 per share.	**9,666**	–
US$630,000 promissory note, payable in equal monthly installments of US$26,250 over 24 months, with the first installment due on February 9, 2000.	**909**	–
Debenture due on November 21, 2003. Simple interest accrues at 10% and is paid at each calendar quarter end. Each $1,000 debenture face value is convertible into 700 common shares, 614 common shares and 547 common shares of the Corporation before November 20, 2001, November 20, 2002 and November 20, 2003, respectively. The Corporation has a right to call for conversion into common shares after November 20, 2000, if the Corporation's common shares trade in excess of $4.00 for 20 consecutive days.	**350**	2,000
US$2,000,000 promissory note	**–**	3,066
	73,671	26,575
Less: current portion	**(5,017)**	(1,533)
	$ 68,654	$ 25,042

The US$13,656,000 notes are issued by the Corporation's wholly owned subsidiary EQII and are secured by a pledge of the shares of EEII and a security interest in the shares of EQII. On February 26, 1999, all note holders granted priority to the Corporation's bank for all assets other than the Corporation's existing rights and interests in Indonesia. In the event the Corporation defaults on two consecutive interest payments or defaults on the payment of principal of the notes, the unpaid principal plus accrued interest can be immediately converted, at the option of the noteholder, into common shares based upon the market price prevailing at the time of default.

The debenture is secured by a pledge of the shares of Pilona and an assignment of certain accounts receivable of Pilona. In connection with the financing, a commission of 2% was paid, and warrants were issued to acquire 75,000 common shares at $1.61 per share which expire on November 20, 2000. These warrants were issued to organizations controlled by two directors.

At December 31, 1999, $611,000 (net of accumulated amortization of $652,000) of unrealized exchange gains relating to U.S. dollar denominated debt and $642,000 (net of accumulated amortization of $95,000) of financing costs have been deferred and will be amortized over the remaining terms of the related debt.

7. Share Capital

(a) Authorized

Unlimited number of common shares without par value
Unlimited number of preferred shares without par value

(b) Issued

	Number of Shares	$
Common Shares		
Balance at December 31, 1997 (consolidated on a 1 for 4 basis)	6,791,387	25,977
Issued for cash		
Flow-through common shares	1,687,523	3,712
Exercise of common share purchase warrants	37,500	53
Issued for acquisition of subsidiary (Note 4)	2,250,000	2,790
Common share issue expenses	–	(485)
Balance at December 31, 1998	10,766,410	32,047
Reduction of common share stated capital	–	(25,967)
Issued for cash		
On exercise of Special Warrants	4,395,000	8,790
Flow-through common shares	2,234,900	4,805
Issued on conversion of debentures	1,155,000	1,650
Issued for services	150,000	307
Tax benefits renounced to flow through investors	–	(3,712)
Common share issue expenses	–	(1,407)
Balance at December 31, 1999	18,701,310	16,513
Series 1 Convertible Preferred Shares		
Issued on purchase of petroleum and natural gas interests (Note 3)	21,134,203	12,000

(c) Common share consolidation and reduction of stated capital

At the Corporation's annual and special meeting held on June 24, 1999, its shareholders approved the consolidation of the issued and outstanding common shares on a one-for-four basis. Accordingly, any reference to the historical number of common shares has been adjusted to reflect this consolidation. The shareholders also approved the application of the December 31, 1998 deficit of $25,967,000 against issued share capital at that date.

(d) Issue of Special Warrants

On May 21, 1999, the Corporation completed a private placement of 4,395,000 special warrants (the "Special Warrants") at $0.50 per Special Warrant for gross proceeds of $8,790,000. Each Special Warrant was exercisable, at no additional cost, into one common share and one-half of one warrant. Each whole warrant was exercisable into one common share, at $2.60 per share, for a period of three years. All of the Special Warrants were exercised on May 27, 1999.

The Corporation's Agent for the private placement was paid an average cash commission of 5.0% of the gross proceeds and received compensation warrants which are exercisable, for no additional consideration, into 250,000 warrants.

(e) Flow-through Shares

At December 31, 1998, a total of $3,712,550 of Canadian Exploration Expenses were renounced to shareholders. The related expenditures were incurred during 1999. The Corporation is obligated to incur expenditures in the year 2000 related to flow-through shares issued during 1999.

(f) Convertible Debentures

Debentures in the amount of $1,650,000 were converted into 1,155,000 common shares in 1999. The remaining $350,000 of convertible debentures are convertible into common shares as set out in Note 6.

(g) Series 1 Convertible Preferred shares

The preferred shares were issued to the vendor of the Corporation's Western Canadian petroleum and natural gas properties, (Note 3), and bear dividends at 6.5% per year. The preferred shares are convertible, at the vendor's option, into a maximum of 5,283,550 Common Shares on or after February 25, 2000.

The Corporation can force conversion after February 25, 2001 if the weighted average trading price of the Corporation's common shares is at least $3.4068 for ten consecutive trading days. Redemption by the Corporation is subject to an initial redemption premium of 12%. The redemption premium declines by 2% per calendar year until it becomes 1% in 2005 and expires thereafter. The preferred shares also entitle the vendor to appoint one director to the Board of Directors of the Corporation. If the Corporation fails to either pay two consecutive dividend payments or comply with certain financial covenants, the vendor can convert all or a portion of the preferred shares into common shares, based upon the market price for the Corporation's common shares prevailing at the time of default. In the event of default, the vendor shall also be entitled, until such time as the preferred shares are converted into common shares, to elect two thirds of the Corporation's Board of Directors.

(h) Warrants

The following warrants for purchase of common shares are outstanding at December 31, 1999:

Date Granted	Number of Common Shares	Exercise Price	Expiry Date
November 20, 1998	37,500	1.61	November 20, 2000
May 21, 1999	2,197,500	2.60	May 21, 2002
February 26, 1999	250,000	2.60	February 25, 2002

No value has been ascribed to any of the warrants for accounting purposes.

8. Stock Option and Share Appreciation Rights Plans

(a) Stock Option Plan

Under the Corporation's stock option plan, the Corporation may grant options to its directors, officers, employees and service providers to purchase common shares at a fixed price not less than the fair market value of the stock on the day preceding the grant date. The maximum term of the options is 10 years. The options are exercisable as to 25% per year beginning on the date of grant.

Options	Number	Weighted Average Exercise Price ($)
Outstanding at December 31, 1997	500,000	6.48
Cancelled during the year	(52,500)	7.37
Outstanding at December 31, 1998	447,500	6.38
Granted during the year	1,558,750	1.40
Cancelled during the year	(293,750)	6.20
Outstanding at December 31, 1999	1,712,500	1.62
Exercisable at December 31, 1999	470,625	2.16

All number of options and prices prior to the share consolidation have been adjusted to reflect such consolidation.

During 1999, 93,750 of the outstanding options at December 31, 1998 with an exercise price of $6.20 were repriced to $1.40. The impact of the repricing has been reflected in the weighted average exercise price of options outstanding at December 31, 1999. None of these options was held by officers or directors.

The following table summarizes information about the Corporation's stock options outstanding at December 31, 1999.

		Options Outstanding		Options Exercisable	
Range of Exercise Prices ($)	Number Outstanding At 12/31/99	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price ($)	Number Exercisable At 12/31/99	Weighted Average Exercise Price ($)
1.40 – 1.45	1,652,500	4.5	1.40	413,125	1.40
6.20	10,000	2.7	6.20	7,500	6.20
7.80	50,000	2.1	7.80	50,000	7.80
1.40 – 7.80	1,712,500	4.4	1.62	470,625	2.16

(b) Share Appreciation Rights Plan

Under the Corporation's share appreciation rights plan, the Corporation may grant to its directors, officers, employees or provider of services, share appreciation rights. Each right entitles the participant to receive from the Corporation an amount equal to the positive difference, if any, obtained by subtracting the assigned amount from the simple average of the closing trading price of the common shares on the TSE for the 20 trading days immediately preceding the date of exercise. The rights are exercisable as to 25% from the date of the agreement and an additional 25% on each of the next three anniversary dates. The rights' maximum term is eight years.

In 1999, stock appreciation rights with reference to 631,250 common shares have been granted with base prices between $1.40 to $1.45 with expiry dates in 2007. A total of $9,293 has been recorded as expense in 1999.

9. Net Income and Cash Flow per Common Share

Net income and cash flow per common share figures have been calculated for the year ended December 31, 1999 using the following numbers of shares:

	1999
Weighted average shares – basic	**13,857,762**
Weighted average shares – fully diluted	
– net income per common share	**17,696,973**
– cash flow per common share	**22,215,421**

Net income and cash flow figures have been reduced by preferred share dividends for purposes of these per common share calculations.

For the year ended December 31, 1998 the weighted average number of common shares used for the basic calculation was 7,463,124, adjusted for share consolidation (Note 7).

10. Segment Information

Equatorial's activities are conducted in two geographic segments, both relating to the exploration, development, and production of oil and natural gas.

The Corporation's two segments operation in Canada and Indonesia. The Corporation's head office is in Canada.

Revenues and Expenses	Canada ($)	Indonesia ($)	Total ($)
Gross oil and natural gas revenue	42,962	29,295	72,257
Royalties and government take	(8,796)	(16,719)	(25,515)
	34,166	12,576	46,742
Operating	11,111	9,058	20,169
Depletion and depreciation	10,514	3,851	14,365
	21,625	12,909	34,534
Segment operating income (loss)	12,541	(333)	12,208
Interest – long-term debt			6,494
Administrative			3,253
Foreign exchange (gain)			(595)
Income before income taxes			3,056
Income taxes			600
Net income			2,456

Segment operating income for 1998 was all derived from Indonesia.

	1999 ($)	1998 ($)
Additions to petroleum and natural gas interests		
Canada	**59,951**	126
Indonesia	**8,382**	11,180
	68,333	11,306
Petroleum and natural gas interests		
Canada	**68,244**	246
Indonesia	**41,585**	37,011
	109,829	37,257

11. Income Taxes

The provision for income taxes includes amounts for both the Canadian and Indonesian operations. The following table reconciles the income tax amounts which would be expected based on Canadian statutory rates of income tax to the amounts recorded:

	1999 ($)	1998 ($)
Income (loss) before income taxes	**3,056**	(24,365)
Expected income taxes of the statutory rate of 45%	**1,375**	(10,964)
Increase (decrease) in income tax expense resulting from		
Canadian crown royalties	**3,160**	–
Canadian resource allowance	**(2,718)**	–
Canadian large corporation tax and provincial capital tax	**408**	–
Income tax impact of amounts which have no tax basis	**963**	3,320
Utilization of previously unrecognized tax loss	**(1,703)**	–
Recovery on previously recorded tax provision	**(1,215)**	–
Unrecognized potential future income tax benefit of amounts deductible for tax purposes	**–**	7,385
Other	**330**	259
Provision for income taxes	**600**	–
Comprises		
Current	**(500)**	–
Deferred	**1,100**	–
	600	–

12. Statement of Cash Flows

	1999 ($)	1998 ($)
Changes in non-cash working capital:		
Accounts receivable	**(7,880)**	(5,537)
Accounts payable and accrued liabilities	**8,717**	1,117
	838	4,420
Cash interest paid during the year	**6,353**	646
Cash taxes paid during the year	**409**	20

13. Hedging and Financial Instruments

The Corporation's financial instruments recognized on the balance sheet include cash, accounts receivable, accounts payable and accrued liabilities and long-term debt. The fair values of financial instruments other than long-term debt approximate their carrying amounts due to the short-term nature of these instruments.

At December 31, 1999, the Corporation had $42 million of variable rate bank loans. There were no instruments in place at December 31, 1999 to fix the interest rate on this variable rate debt. At December 31, 1999 and 1998 the reported value of the long-term debt approximates their fair value.

The Company has debt denominated in both US dollars and Canadian dollars. In addition, the Company's revenue stream is essentially based in US dollars although the Company reports in Canadian dollars. The Company has no instruments in place at December 31, 1999 to fix the exchange rates on these items.

The nature of the Corporation's operations results in exposure to fluctuations in commodity prices. The Corporation enters into contracts to hedge a portion of its exposure to commodity risks.

The Corporation is exposed to credit-related losses in the event of non-performance by counter-parties. Hedge contracts have been entered into with the bank that has provided the revolving and term bank credit facility. The Company remains exposed to credit related losses with all other counter-parties.

1999 Hedging

As a result of commodity hedging transactions, oil and natural gas revenues for 1999 were reduced by $2,458,428 (1998 – nil).

2000 Hedging

The Corporation has entered into natural gas and crude oil contracts for 2000 and future years as follows:

Delivery Period	Quantity Per Day	Price	Nature of Contract
Gas			
January 1, 2000 to March 31, 2001	13,000 mmbtu	$ 2.25	Swap
April 1, 2001 to June 30, 2003	13,000 mmbtu	$ 2.40	Sold a call
Oil			
January 1, 2000 to April 30, 2001	500 bbls	$ 14.00	Swap
May 1, 2001 to April 30, 2004	500 bbls	$ 18.65	Sold a call

14. Commitments

The Corporation is committed under a lease of office premises to annual rental payments approximating $183,822 for each of the next four years.

15. Comparative Figures

Certain of the comparative figures have been reclassified to conform to the presentation adopted for current year.

Glossary

API gravity: the American Petroleum Institute's standard for weight per unit of volume of crude oil, given in degrees — higher API gravity crude is more valuable

bcf: billion cubic feet

boe: barrel of oil equivalent

boepd: barrels of oil equivalent per day

bopd: barrels of oil per day

develo-cat well: a development well outside the currently defined pool boundaries

mcf: thousand cubic feet

mD: millidarcy, a measurement of permeability

mmbtu: millions of British thermal units

mmcf: million cubic feet

mmstb: million stock tank barrels (a stock tank barrel is a barrel of oil at the earth's surface — stock tank oil lacks much of the dissolved gas present at reservoir pressure and temperatures)

mmstboe: million stock tank barrels of oil equivalent

mstb: thousands stock tank barrels

spud: to begin drilling a well

WTI: the West Texas Intermediate crude oil price, an industry standard

Board of Directors

Robert R. Rooney [2,3]
Chairman, the Board of Equatorial, and Partner, Bennett Jones, Barristers and Solicitors

G. Marshall Abbott [2]
President and Chief Executive Officer
Equatorial Energy Inc.

David N. Matheson
Executive Vice-President
Equatorial Energy Inc.

Nabih A. Faris [1]
President
Intergulf Group of Companies

Henry W. Sykes [1]
Senior Vice-President, Business Development, and General Counsel
Gulf Canada Resources Limited

Peter Meredith [1,2,3]
Chief Financial Officer
Ivanhoe Capital Corporation

Douglas G. Manner [3]
Chief Operating Officer
Gulf Canada Resources Limited

Officers

G. Marshall Abbott
President and Chief Executive Officer

David N. Matheson
Executive Vice-President

John R. Rooney
Senior Vice-President and Chief Financial Officer

Solicitors

Bennett Jones
Calgary, Alberta

Bankers

The Chase Manhattan Bank of Canada
Bank One Canada

Auditors

Deloitte & Touche LLP
Calgary, Alberta

Transfer Agent

Valiant Corporate Trust Company
Calgary, Alberta

Stock Exchange Listing

Listed on the Toronto Stock Exchange
Trading symbol: OZ

Head Office

2700 Western Gas Tower
530 – 8th Avenue SW
Calgary, Alberta, Canada T2P 3S8
Telephone (403) 264-9562
Fax (403) 234-0322
Toll-free 1-888-608-1866

Web Site

www.equatorial.net

Annual General Meeting

3:00 p.m. May 18, 2000
The Metropolitan Centre
333 – 4th Avenue SW
Calgary, Alberta

Notes:
1. Audit Committee
2. Compensation Committee
3. Reserves Committee

equatorial energy inc.

2700 Western Gas Tower

530 – 8th Avenue SW

Calgary, Alberta

Canada T2P 3S8

Telephone (403) 264-9562

Fax (403) 234-0322

Toll-free 1-888-608-1866

www.equatorial.net

Designed and produced by KARO Printed in Canada